GENERAL FUND PRELIMINARY BUDGET PROJECTIONS: 2003 BIENNIUM

Prepared for the

Legislative Finance Committee

by

LFD Staff

October 2, 2000

INTRODUCTION

PURPOSE AND SUMMARY

The purpose of this report is to provide the Legislative Finance Committee (LFC), the Revenue and Taxation Committee, and the members of the legislature with a preliminary projection of the general fund balance for the 2003 biennium at present law levels of revenue and expenditure. The availability of funding for new and expanded programs will also be discussed. This report is intended to provide a broad overview of the scope of present law fiscal issues the legislature may face in the 2001 session. These projections are based on "broad brush" general assumptions of expenditure and revenue patterns from the most current available information, and will be refined as staff undertake detailed budget analysis and revenue estimation in preparation for the 2001 legislative session.

The projected present law ending general fund balance for the 2003 biennium is $30.9 million. If the ballot initiatives to be voted on in November are included, the general fund balance declines to a negative $25.4 million. This represents an available balance for policy decisions on present law expenditures, new initiatives, tax reform, and a general fund reserve. This outlook represents a significant decline from the $96.9 million balance the legislature was anticipating upon adjournment of the special session in May (see Table 6). The primary reasons that have contributed to this decline are: 1) an increase in the growth of expenditures, including significant increases in human services and corrections costs; and 2) unanticipated human services and wildfire supplementals.

The assumptions used in making the projections and the adjustments made to derive present law are discussed in the body of the report.

SCOPE OF REPORT

As described above, this report focuses on the projected fund balance in the general fund. In addition to the projection, it includes: 1) a review of the 2001 biennium projected fund balance that is carried forward into the 2003 biennium projection; and 2) a discussion of the historical and current perspective of the structural balance in the general fund account.

Present law levels represent the amount necessary to continue programs and services authorized by the previous legislature, and include caseload and workload increases, and enrollment adjustments. Statute requires that the executive submit a present law budget to the legislature and that the Legislative Fiscal Analyst (LFA) provide an analysis of present law.

This report does <u>not</u> discuss in detail nor do the numbers include other fiscal issues that may face the 2001 legislature, including the highways fund balances, de-earmarking proposals, tax reform, preliminary executive budget new proposals, revenue litigation, or the potential impact of voter initiatives.

2001 BIENNIUM PROJECTED FUND BALANCE

Based on the fiscal 2000 preliminary ending fund balance, revised revenue and expenditure estimates for fiscal 2001, and anticipated supplementals, the 2001 biennium general fund ending balance is estimated to be $33.9 million. Table 1 shows the general fund balance as reported in the Legislative Fiscal Report – Special Session, May 2000, the current LFD revenue and expenditure projections, and the differences between the legislative and LFD revised estimates.

The general fund account is now expected to end the 2001 biennium with about $34.1 million less than anticipated by the 56th Legislature in the May 2000 Special Session. This decrease is due primarily to an increase in supplemental appropriations of $23.8 million and accounting adjustments (downward) which resulted in a reduction of $12.8 million. The supplemental requests are discussed on page 4. The accounting adjustments were identified after the fiscal 2000 year-end close of the state accounting records and were items that were not known or anticipated for the May 2000 Special Session. A majority of the adjustments were related to revenue collections.

There is a noticeable increase of $45.8 million in estimated revenue and $33.9 million in statutory appropriations. These two figures include the receipt and expense of $37.1 million in Federal Emergency Management Administration (FEMA) funds that resulted from the Montana wildfires.

Table 1
Comparison of 2001 Biennium
General Fund Account (In Millions)

	Special Session 2001 Biennium	Revised 2001 Biennium	Difference 2001 Biennium
Beginning Fund Balance	**$109.674**	**$109.674**	**$0.000**
Revenues			
Current Law Revenue	2,296.409	2,342.211	45.802
Residual Transfers	1.840	(1.811)	(3.651)
Total Funds Available	**$2,407.923**	**$2,450.074**	**$42.151**
Disbursements			
General Appropriations	2,110.278	2,109.065	(1.213)
Statutory Appropriations	92.661	126.597	33.936
Local Assistance Appropriations	70.584	70.584	
Economic Development Appropriations	13.265	13.265	(0.000)
Miscellaneous Appropriations	8.487	6.873	(1.614)
Continuing Appropriations		7.912	7.912
Supplemental Appropriations	14.900	38.654	23.754
Feed Bill Appropriations	5.865	5.438	(0.427)
Anticipated Reversions	(3.135)	(2.067)	1.068
Total Disbursements	**$2,312.905**	**$2,376.321**	**$63.416**
Adjustments	9.931	(2.854)	(12.785)
Local Government Reserve	(37.000)	(37.000)	
Ending Fund Balance	**$67.949**	**$33.899**	**($34.050)**

Legislative Initiatives Not Included in Table 1			
SB13 Create Tobacco Trust Fund	(10.130)	(10.130)	
Potential Ending Fund Balance	**$57.819**	**$23.769**	**($34.050)**

FISCAL 2001 SUPPLEMENTAL APPROPRIATIONS

Supplemental appropriations are anticipated to total approximately $38.7 million in the 2001 biennium. The projected supplementals include: 1) $14.0 million for fire suppression costs[1], including fiscal 2000 costs of over $4.0 million (this figure does not include any estimated reimbursement revenue) 2) $9.8 million for K-12 guaranteed tax base expenditures; 3) $14.0 million for Medicaid payments and for non-Medicaid mental health costs in the Department of Public Health and Human Services; 4) $600,000 associated with bond costs of the Zortman-Landusky mines in the Department of Environmental Quality; and 5) $250,000 to the Montana Historical Society for costs associated with storing the newly donated Robert Scriver art collection. During special session, fire costs were estimated at $4.3 million, and the executive indicated that the Department of Public Health and Human Services would not request any supplemental appropriation.

SIGNIFICANT ISSUES NOT INCLUDED IN 2001 BIENNIUM PROJECTIONS

Tobacco Settlement Referendum

The legislature in the May 2000 Special Session enacted SB 13, submitting a legislative referendum to the voters. If approved by the electorate, the referendum will amend the constitution to require the legislature to dedicate at least 40 percent of tobacco settlement proceeds to a trust fund. The principal of the trust fund will be inviolate, but a portion of interest and income from the trust will be available for the legislature to appropriate. Interest and income will be allocated: 1) 90 percent for tobacco disease prevention programs and programs related to the health care needs of Montanans; and 2) 10 percent for deposit to the trust fund. The constitutional amendment will become effective when approved by the electorate.

Approval of the amendment will reduce fiscal 2001 estimated general fund deposits by 40 percent, or $10.1 million.

2003 BIENNIUM BUDGET PROJECTION

Table 2 shows the projected present law general fund revenues and expenditures for the 2003 biennium. Based on the revenue and present law expenditure assumptions discussed below, there will be a general fund balance of $30.9 million by the end of fiscal 2003. This represents funds available for a general fund reserve and legislative policy decisions on expenditure levels and tax policy. It should be noted that if the three initiatives listed in Table 2 are approved, the general fund balance would be a negative $25.4 million.

---

[1] Please note that this figure is extremely tentative at this time. Total supplemental costs are estimated to range between $10 million and $19 million, depending upon further fall fire activity and the timing of reimbursements from FEMA. If FEMA reimbursements are delayed, the amount the state must pay up front pending reimbursement of the full $37.1 million anticipated from that source will increase. In addition, the total does not include any fire costs that will be paid from the Governor's Emergency Fund statutory appropriation estimated in this report at $4.0 million.

Table 2
2003 Biennium Projections
General Fund Account (In Millions)

	Revised 2001 Biennium	Present Law 2003 Biennium	Difference
Beginning Fund Balance	**$109.674**	**$33.899**	**($75.775)**
Revenues			
Current Law Revenue	2,342.211	2,406.275	64.064
Residual Transfers	(1.811)	(4.609)	(2.798)
Total Funds Available	**$2,450.074**	**$2,435.565**	**($14.509)**
Disbursements			
General Appropriations	2,109.065	2,213.942	104.877
Statutory Appropriations	126.597	87.480	(39.117)
Local Assistance Appropriations	70.584	70.584	
Economic Development Appropriations	13.265	16.430	3.165
Miscellaneous Appropriations	6.873	6.794	(0.079)
Continuing Appropriations	7.912		(7.912)
Supplemental Appropriations	38.654	7.000	(31.654)
Feed Bill Appropriations	5.438	5.438	
Anticipated Reversions	(2.067)	(3.000)	(0.933)
Total Disbursements	**$2,376.321**	**$2,404.668**	**$28.347**
Adjustments	(2.854)		2.854
Local Government Reserve	(37.000)		37.000
Ending Fund Balance	**$33.899**	**$30.897**	**($3.002)**

Legislative Initiatives Not Included in Table 2				
SB13	Create Tobacco Trust Fund	(10.130)	(24.042)	(13.912)
HB7	Eliminate Inheritance Tax		(19.158)	(19.158)
HB540	Public School Support GTB		(3.000)	(3.000)
Potential Ending Fund Balance		**$23.769**	**($25.433)**	**($49.202)**

ASSUMPTIONS USED IN PRESENT LAW PROJECTIONS

Present law projections include 2001 biennium fund balances at present law operations, which are defined as the level necessary to continue existing services authorized by the previous legislature. Present law is used rather than actual fiscal 2000 expenditures in order to account for inflation and other costs, such as annualization of the state employee pay plan. It is also used because statute requires the executive to submit a present law budget, and the LFD to provide a present law analysis. Present law expenditures are at the levels established by the legislature in the 1999 session and adjusted in the May 2000 Special Session, with adjustments for caseload and enrollment increases. The present law projections do not include funding for increases in employee pay, the K-12 BASE aid funding schedules, or human services provider rates beyond the changes made by the 1999 legislature either in regular or special session. No funds are included for new programs, tax policy revisions, or legislative initiatives.

ENDING FUND BALANCE RESERVE

An ending fund balance reserve allows for unexpected expenditures and variations in actual revenue collections versus projections. The projected ending fund balance for the 2003 biennium is $30.9 million, with no reserve. It also does not include the potential approval of three ballot initiatives by voters in November. If the initiatives are approved, the 2003 projected fund balance would be a negative $25.4 million. For the purpose of this report, no ending fund balance reserve is suggested as this issue has been considered a legislative fiscal policy.

Recently, the general fund reserve set by the legislature has been around $50.0 million, or just over 2 percent of total revenues. A general fund reserve of at least 2.5 percent of total biennial revenues is considered prudent by national budget experts. The calculation of the target ending fund balance -- based on 2.5 percent of total biennial general fund revenues as “recommended” by budget experts, results in a budget reserve of $60.0 million.

REVENUES

Revenue included in the 2003 biennium projections is estimated collections under state and federal law and accounting procedures, with the rates and allocation percentages as specified under current law. The projected revenues for fiscal 2001 through 2003 contained in this report are preliminary estimates, based on fiscal 2000 actual collections and current economic trends. These revenue projections will be subject to more in-depth analysis and refined later in calendar 2000, as the Revenue and Taxation Committee undertakes its statutory duty to prepare a revenue estimate for presentation to the 2001 legislature.

EXPENDITURES

The base used to project 2003 biennium expenditures is the fiscal 2001 appropriated level authorized by the 56th Legislature in regular and special session, adjusted for cyclical expenditures such as biennial appropriations. The following additional adjustments were made in projecting present law costs into the 2003 biennium:

- personal services costs are at the level of FTE authorized by the 56th Legislature, with adjustments to reflect continuation of the 2001 biennium pay plan;
- anticipated enrollment changes in K-12 and the university system have been included;
- caseload and entitlement adjustments in human services and corrections programs (including Medicaid and prison population) anticipated under present law are included;
- budget modifications and miscellaneous ("cat and dog") appropriations enacted by the 56th Legislature were excluded if they were designated as one-time expenditures, while those funding ongoing duties were included in the present law projections;
- appropriations phased in during the 2001 biennium are funded for the entire biennium; and
- supplemental appropriations projected to continue in the 2003 biennium are included.

Any budget reductions enacted for the 2001 biennium are continued with the exception of vacancy savings. The vacancy savings contingency appropriated by the 1999 legislature to aid agencies unable to meet their personal services costs was not incorporated in the projected 2003 biennium figures.

ADJUSTMENTS TO DERIVE PRESENT LAW

Table 3 compares the combined revenue and expenditure estimates for the 2001 biennium to the preliminary combined revenue and expenditure estimates for the 2003 biennium. The major factors causing the changes are discussed below.

Table 3
Comparison of Revenues and Expenditures
General Fund Account (In Millions)

	Revised 2001 Biennium	Present Law 2003 Biennium	Difference
Revenues	$2,342.211	$2,406.275	$64.064
Expenditures	2,376.321	2,404.668	28.347

INCREASES IN REVENUE

As shown in Table 3, general fund revenues are anticipated to increase $64.1 million in the 2003 biennium, a growth rate of 1.4 percent per year.

Major components of this increase are the net of income tax ($114.9 million), property tax (a negative $1.1 million), corporation tax (a negative $27.4 million), telecommunications excise tax ($12.6 million), and foreign depository revenue ($10.2 million). The anticipated $37.1 million in FEMA revenue only occurs in the 2001 biennium.

Income Tax

Income tax revenues during the 2003 biennium are estimated to increase by $114.9 million from the 2001 biennium, or 11.0 percent.

The estimates of income tax revenue depend on assumptions for growth in employment, wages and salaries, capital gains income, and other income types. Growth in employment in calendar 1997 and 1998 was a little over 2.2 percent in each year. Employment growth in calendar 2000 is expected to continue at this pace. However growth is expected to fall to around 2.1 percent thereafter.

Wages and salaries are expected to grow 6.1 percent from calendar 1998 to 1999 and five percent thereafter. The average growth in wages between calendar 1992 and 1998 was 5.2 percent. Growth in wages in the first quarter of 2000 relative to growth in the same quarter in 1999 has been weak, at only 3.5 percent.

Capital gains income grew by more than 32 percent in calendar 1997 and by 30 percent in 1998, due mainly to a vibrant stock market. Capital gains income is expected to grow slower in the future with the growth between 1998 and 1999 expected to be only 15 percent, between 1999 and 2000 to be zero percent, and ten percent thereafter. The slower growth is the result of slower economic expansion and the effect this has on equity markets.

Property Tax

Property tax revenues during the 2003 biennium are expected to decline by $1.1 million or 0.3 percent. As a result of legislation passed during the 1999 legislative session and during the special session in May 2000, the amount of property tax revenue collected by the state will decline sharply beginning in fiscal 2001. Passed during the regular session in 1999, SB 200 reduced the tax rate on business equipment to 3 percent from 6 percent, HB 174 and HB 128 reduced the tax rate on electrical generation property and telecommunications property, respectively, from 12 percent to 6 percent, and SB 184 reduced the residential and commercial real estate tax base. As a result, property taxes generated by the statewide 95 mill levy will decline by $21.0 million between fiscal 2000 and 2001. Beginning in fiscal 2002, growth of around 3 percent per year in statewide taxable value is expected.

SB 111, passed during the regular session in 1999, will also reduce property tax revenues during the 2003 biennium. SB 111, which allows companies with centrally assessed property to reduce taxable market values by exempting intangible personal property, will reduce state property revenues by approximately $0.3 million in fiscal 2001, and by $9.0 million during the 2003 biennium.

In addition, HB 4 from the May 2000 Special Session eliminated the allocation of motor vehicle revenue to the state 55 mill levy. This will reduce property taxes in the general fund by an additional $8.3 million per year, beginning in fiscal 2001.

Corporation Tax

Corporation taxes are expected to decline by $27.4 million in the 2003 biennium. This is mainly the result of the one-time payment of capital gains taxes by Montana Power Company during the 2001 biennium as a result of the sale of MPC's power generation assets in December 1999.

Not included in either the 2001 or the 2003 biennium estimates of corporation tax revenue is the potential capital gains tax revenue from three further announced sales by Montana Power Company. MPC has announced the sale of its oil and natural gas exploration, production, and marketing operations to PanCanadian Petroleum Ltd. of Calgary for $475 million. MPC has also announced the sale of its coal mining business to Westmoreland Coal Company for $138.0 million. MPC has also announced the sale of its independent power operations division, Continental Energy Services, to BBI Power Corporation (based in Maryland) for $84.5 million. These sales are expected to be completed before the end of calendar 2000, or in the first half of 2001.

The amount of capital gains tax revenue the state will receive from these sales is unknown. The capital gains tax revenue from these sales will depend on four factors: the tax basis of the property sold, the Montana allocation factor allocating capital gains to the state, the amount of sale profits MPC may share with its power distribution customers, and the amount MPC invests in its telecommunications arm, TouchAmerica. Investing in telecommunications capital equipment will generate depreciable deductions which will reduce MPC capital gains tax liability.

Also unknown, and therefore not included in the corporation tax estimates, is the impact of the sale by MPC of its electrical transmission and distribution assets. No buyer of these assets has been announced. Further, once a buyer has been announced, the Montana Public Service Commission as well as federal agencies will need to approve the sale.

Telecommunications Excise Tax

HB 128, passed during the 1999 legislative session, abolished the telephone license tax and established the telephone excise tax. The excise tax is 3.75 percent of the retail price of telecommunications services, whereas the license tax was 1.8 percent of gross revenues.

The license tax collections were about $6.0 million in fiscal 1999. The fiscal note accompanying HB 128 estimated that the new license tax would generate $12.4 million in revenue in fiscal 2000 and $25.9 million in fiscal 2001.

Actual collections from the new license tax in fiscal 2000 were only $6.4 million. Further research is required to determine the reasons for this shortfall. The estimates of revenue contained in this report for the 2003 biennium are about $24.0 million per year consistent with the fiscal note prepared during the 56th Legislative Session.

Foreign Depository Revenue

SB 83, passed during the 1997 regular session created the foreign depository act. This act imposes a tax rate of 1.5 percent on the average balances residing in the depository. SB 2, passed during the special session in May 2000, reduced the rate to 0.75 percent and clarified the calculation of the base on which the tax is based.

The 2003 biennium revenue estimates include $11.5 million in revenue from this source. This estimate is based on a preliminary business plan submitted by one company to the Department of Commerce. Although this estimate has been included in the total general fund projections, there is a significant downside risk that this revenue will not materialize at the projected amount.

INCREASES IN PRESENT LAW EXPENDITURES

The projections for the 2003 biennium show that the costs of funding a present law budget would be a net increase of $28.3 million over the 2001 biennium. The major factors causing this increase are summarized in Table 4 and described in more detail below.

Table 4
Increases in Present Law Expenditures
2003 Biennium
in Millions

Category	General Fund
Pay Plan	$12.7
K-12 Education	(5.0)
Higher Education	2.8
Human Services	63.2
Corrections	23.7
Supplementals	(31.7)
Statutory Appropriations	(39.1)
Other	1.7
Total Difference	$28.3

Pay Plan

The 1999 legislature appropriated $21.9 million general fund over the biennium for the state employee pay plan ($24.16 million other funds), including contingency funds for agencies unable to meet vacancy savings requirements. This appropriation primarily funded three increases: 1) a 3 percent per year salary increase; 2) an increase in insurance; and 3) an adjustment for timing issues in university system insurance contributions. (The legislature also provided a longevity increase. However, agencies were not given additional funds in the pay plan bill for the longevity adjustments, but were expected to fund the increase from existing appropriations.) Because the legislature delayed the implementation of the salary and insurance increases, and because additional unfunded longevity costs will now be built into the budget, personal service costs will increase in the 2003 biennium even if salaries and insurance are frozen. Total general fund costs are estimated to increase about $12.7 million over the 2001 biennium appropriated level.

K-12 Education

Present law expenditures for K-12 during the 2003 biennium are expected to decline relative to the 2001 biennium by $5.0 million, or 0.6 percent for the biennium.

If SB 100 (regular 1999 session) and HB 4 (special session in May 2000) had not passed, state general fund K-12 costs during the 2003 biennium would have declined by approximately $35.0 million compared with the 2001 biennium, due primarily to enrollment declines which have fallen during the 2001 biennium and are expected to decline at close to the same rate during the 2003 biennium.

The passage of SB 100 and HB 4 substantially increased state K-12 expenditures by increasing the proportion of direct state aid received by each school and by increasing district entitlements. The two bills impacted the 2001 biennium only partially by concentrating the largest impact in fiscal 2001. Combined, the two bills will have boosted state spending on K-12 by approximately $64.0 million in the 2001 biennium and by $94.0 million in the 2003 biennium, relative to what would have been present law in their absence.

As a result, with the passage of SB 100 and HB 4, the increase in state general fund expenditures between biennia will be $30.0 million, which will be offset by a decline of $35.0 million due to enrollments. The net biennial difference is therefore a decline of $5.0 million.

Compared with ANB in fiscal 2001, elementary ANB are expected to decline by 2,295 (-2.2 percent) in fiscal 2002 and by an additional 1,105 (-1.1 percent) in fiscal 2003. High school ANB are expected to decline relative to ANB in fiscal 2001 by 106 (-0.2 percent) in fiscal 2002 and by 891 (-1.7 percent) in fiscal 2003.

The estimates of state K-12 expenditures for the 2003 biennium were calculated on the assumption that state property tax reimbursements for districts' general fund in the 2003 biennium will be at the same level as in the 2001 biennium, as required in SB 184. State reimbursements to districts' general fund during the 2001 biennium are not for a full two years – in fact they represent only 63 percent of a full two years worth. Present law for the 2003 biennium presumes that state reimbursements will also be 63 percent of two years' worth. If the 57th Legislature decides to fully reimburse districts for the property tax legislation passed during the 1999 session, K-12 expenditures during the 2003 biennium will fall by $5.6 million.

In November 2000, voters statewide will vote on HB 540, the motor vehicle initiative which would place light vehicles on a fee instead of an ad valorem tax basis. If HB 540 passes, school districts will receive less motor vehicle revenue. As a result, state GTB costs during the 2003 biennium will increase by $3.0 million.

Higher Education

General fund costs for the Montana University System, excluding pay plan costs which are reported separately, are projected to increase $2.8 million from the 2001 biennium appropriated levels to approximately $245.8 million for the 2003 biennium.

General fund increases include:
- $0.3 million for a projected 164 student FTE enrollment increase in the 2003 biennium from the fiscal year 2001 budgeted level for the six units and colleges of technology;
- $0.3 million for annualizing costs that were phased-in during the 2001 biennium, including WICHE and WWAMI student assistance costs, and other new proposals approved by the 1999 legislature;

- $1.7 million to offset 6 mill revenue estimate differences between fiscal years in the 2001 biennium;
- $2.5 million for fully funding personal services; and
- $0.3 million for operations and maintenance costs for new facilities (approved by previous legislatures) coming on-line during the 2003 biennium.

Offsetting decreases include:

- $1.1 million for one-time only appropriations in the 2001 biennium for performance audit costs, payments to tribal colleges for enrolled resident non-beneficiary students, and funding support for the Montana Beef Network; and
- $1.0 million for reduced state support for the three community colleges reflecting a projected 386 student FTE enrollment decrease from 2001 biennium budgeted levels.

Human Services

The Department of Public Health and Human Services (DPHHS) present law budget is estimated to be $63.2 million general fund higher in the 2003 biennium compared to the 2001 biennium. The biennial general fund value of the most significant present law adjustments within DPHHS are:

- primary care and long-term care Medicaid caseload, utilization, and inflationary increases of $20 million;
- mental health services costs of $16.0 million;
- $9.9 million to comply with a legislative audit finding that drug rebate revenue should be deposited to the general fund instead of using it to rebate service costs (there is a corresponding increase in revenue);
- annualization of the Children's Health Insurance Program (CHIP) of $5.4 million;
- foster care and subsidized adoption caseload increases of $3.8 million; and
- an increase of $4.4 million due to a shift in funding from the Social Services Block Grant (Title XX) as a result of a reduction in the federal grant and limitation on the amount of Temporary Assistance for Needy Families (TANF) Block Grant funds that may be transferred to Title XX.

Cost increases are partially offset by:

- shifting $6.4 million of federal CHIP funds to cover part of the general fund cost in mental health services; and
- general fund revenue increases of $9.9 million in compliance with legislative audit findings on drug rebates.

Corrections

General fund costs in the 2003 biennium are anticipated to increase by approximately $23.7 million over the 2001 biennium appropriations. The following factors are driving the majority of this increase:

Adult Offender Caseloads – Based on the Department of Corrections' most recent projections, male offender populations are expected to increase from 2,766 in fiscal 2000 to 3,239 in fiscal 2003 (approximately a 5.4 percent increase each year). Female populations are projected to increase from 285 in fiscal 2000 to 351 in fiscal 2003 (approximately a 7.0 percent increase each year). Using the department's projections and the allocation of inmates among the various facilities, the LFD estimates the following biennial increases for adult offenders:

Contract beds costs - $10.0 million
Community Corrections costs - $4.3 million

Montana State Prison costs - $1.7 million
Montana Women's Prison costs - $1.4 million

Juvenile Offender Caseloads - The 1999 legislature approved an expansion of the Pine Hills Youth Correctional Facility to 144 beds. Youth at this facility are projected to increase from 65 in fiscal 2000 to 135 in fiscal 2003 (over a 20.0 percent increase each year). Based on these projections, costs at Pine Hills are projected to increase $1.6 million.

Pay Exception – The Department of Administration granted a pay exception to correctional officers in an attempt to improve recruitment and retention of these positions. An additional $1.00 per hour in fiscal 2001 and another $1.00 per hour in fiscal 2002 will cause an increase of $5.9 million for the 2003 biennium.

In fiscal 2000, the department added 59.0 modified FTE and a probation and parole treatment plan in the 2001 biennium, not included in the appropriation made by the 1999 legislature. The department must request continuance of these additions in new proposals. The total general fund cost in the 2003 biennium would be approximately $5.0 million.

Supplementals – Fire Suppression

The present law budget projections (Table 3) assume no general fund supplementals in the 2003 biennium other than $7.0 million in fire suppression costs, compared to the estimated $38.7 million in the 2003 biennium. Historically, general fund supplementals are needed in every biennium, due to changing circumstances after the legislature sets the budget. However, since it is impossible to predict in fiscal 2001 what the 2003 biennium supplementals will be, only an estimate for fire suppression costs is included in the budget projections.

Table 5
General Fund Supplementals for Fire Suppression Costs

Biennia	Millions
1985	2.9
1987	3.7
1989	12.6
1991	3.0
1993	7.9
1995	15.5
1997	4.5
1999	9.0
2001	14.0
2003	7.0

Traditionally, the legislature has not included funds for fire suppression costs in the Department of Natural Resources and Conservation (DNRC) budget, since the costs vary significantly from year to year as shown in Table 5. Instead, the next legislature approves supplementals for costs incurred and anticipated during the biennium. As stated earlier, the fire supplemental appropriation could range from $10.0 million to $19.0 million in the 2001 biennium, with an additional $37.1 million in costs paid by FEMA that would ordinarily have been the responsibility of the state general fund. Please note that a portion of the costs between $10.0 and $19.0 million would be reimbursed from the $37.1 million anticipated from FEMA).

Statutory Appropriations

Statutory appropriations decrease from the 2001 biennium to the 2003 biennium by $39.1 million. This reduction is primarily due to two factors: 1) receipt and expenditure of $37.1 million from FEMA for fire costs; and 2) expenditure of an estimated $6.5 million from the Governor's Emergency Fund (of which $4.0 million is estimated fire costs). Partially offsetting this reduction is an increase in debt services. Debt service for the 2001 biennium is expected to total approximately $30.1 million, while estimates for the 2003 biennium are $37.7 million. The increase is primarily due to the issuance of additional debt authorized by the 1999 Legislature.

Other

The "other" category includes the net impact of a number of miscellaneous adjustments anticipated in the 2001 biennium, including any increased benefit contribution rates, and annualization of partial-year expenditures. In addition, it includes the impact of the following three factors.

Fixed Costs

Fixed costs funded with general fund are estimated to increase by $3.4 million over the level appropriated in the 2001 biennium, primarily in insurance, SABHRS support costs, and data network fees.

Vacancy Savings

The 2001 biennium includes a reduction of approximately $9.0 million over the biennium due to the imposition of a 3 percent vacancy savings rate on the personal service costs of most positions. Because whether to maintain a vacancy savings rate, at what level, and on what positions is a matter of legislative policy, no vacancy savings is assumed in the 2003 biennium.

Elimination of One-Time Expenditures

One-time expenditures added by the 1999 legislature are not continued in present law. In addition to reductions already reflected in the corrections, human services, and higher education narrative, a further $6.3 million was removed.

NEW PROPOSALS AND OTHER INITIATIVES

In every biennium, the governor requests and the legislature approves increases beyond the present law budget, referred to as "new proposals." In addition, an employee pay plan and various legislative initiatives are considered and approved. In recent biennia, the total cost of such items has ranged from $78.1 million (1997) that included $31.4 million for disbursement for tax relief initiatives to $188.0 million (2001) that included $72.8 million for local government reimbursements and $39.1 million for initiatives approved in the May 2000 Special Session. Since funding for an expanded level budget is a matter of legislative policy and prioritization, no projection is provided. However, in the context of preliminary budget projections, the legislature needs to be aware of the likelihood, based upon historical data, of such potential costs.

SIGNIFICANT ISSUES NOT INCLUDED IN 2003 BIENNIUM PROJECTIONS

TOBACCO SETTLEMENT REFERENDUM

The legislature enacted SB 13 in the May 2000 Special Session, submitting a legislative referendum, on use of tobacco settlement proceeds, to the voters. It is explained in an earlier section describing significant fiscal issues for the 2001 biennium. The issue is the same for the 2003 biennium. However, approval of the amendment will reduce fiscal 2003 estimated general fund deposits by 40 percent or $24.0 million.

INHERITANCE TAX INITIATIVE - HB 7

During the May 2000 Special Session, the legislature passed HB 7, which is a referendum for the repeal of the state inheritance tax for deaths occurring after December 31, 2000. The revenue loss in the state general fund is expected to be $19.2 million during the 2003 biennium if approved by the voters.

MOTOR VEHICLE INITIATIVE – HB 540

If passed in November 2000, HB 540 would abolish the new car sales tax and the ad valorem tax on light vehicles, and would establish a registration fee system for light vehicles based on age of the vehicle beginning January 1, 2001. Vehicles between zero and 4 years of age would pay $195 per year, between 5 and 10 years of age, $65 per year and vehicles over 10 years of age would pay $6 per year.

The passage of HB 540 will have two impacts on the state. Because school districts would receive less motor vehicle revenue in their general fund and counties in their school retirement fund, state GTB costs will increase by approximately $3.0 million during the 2003 biennium. In addition, HB 540 abolishes the new car sales tax which currently flows into the highway account. The loss of this revenue will be partially made up by distributing the new registration fee on new vehicles to the highway account. The net loss to the highway account will be $6.1 million per year during the 2003 biennium. Some of this would be recouped because HB 540 directs that the highway account receive its own interest earnings beginning January 1, 2001.

The passage of HB 540 will not affect state general fund revenues. The distribution of any motor vehicle tax (or new registration fee) revenue to the general fund was eliminated by HB 4, passed during the special session in May 2000. Thus even if HB 540 does not pass, the general fund will receive no revenue from motor vehicle taxes.

COMPARISON TO SPECIAL SESSION PROJECTION FOR 2003 BIENNIUM

The projected 2003 biennium fund balance in this report is $66.0 million less than was projected during the special session in May 2000. Table 6 is a reconciliation of this difference. It is followed by an explanation of the factors that caused this difference.

Table 6
Special Session vs. Revised 2003 Biennium Projections
General Fund Account (In Millions)

	Special Session 2003 Biennium	Present Law 2003 Biennium	Difference
Beginning Fund Balance	**$67.949**	**$33.899**	**($34.050)**
Revenues			
Current Law Revenue	2,376.440	2,406.275	29.835
Residual Transfers	(4.000)	(4.609)	(0.609)
Total Funds Available	**$2,440.389**	**$2,435.565**	**($4.824)**
Disbursements			
General Appropriations	2,154.271	2,213.942	59.671
Statutory Appropriations	93.134	87.480	(5.654)
Local Assistance Appropriations	70.584	70.584	
Economic Development Appropriations	16.430	16.430	
Miscellaneous Appropriations	6.794	6.794	
Continuing Appropriations			
Supplemental Appropriations		7.000	7.000
Feed Bill Appropriations	5.438	5.438	
Anticipated Reversions	(3.137)	(3.000)	0.137
Total Disbursements	**$2,343.514**	**$2,404.668**	**$61.154**
Adjustments			
Local Government Reserve			
Ending Fund Balance	**$96.875**	**$30.897**	**($65.978)**

Legislative Initiatives Not Included in Table 6				
SB13	Create Tobacco Trust Fund	(24.042)	(24.042)	
HB7	Eliminate Inheritance Tax	(19.158)	(19.158)	
HB540	Public School Support GTB		(3.000)	(3.000)
Potential Ending Fund Balance		**$43.545**	**($25.433)**	**($68.978)**

BEGINNING FUND BALANCE

The decrease in beginning fund balance for the 2003 biennium is primarily due to two factors related to the 2001 biennium: 1) expenditure increases from additional supplementals in DPHHS and for wildfires; and 2) a $5.9 million reduction in expected revenue from foreign depository taxes.

REVENUE INCREASE

Although there were many minor adjustments, both positive and negative, in 2003 biennium revenues, the net increase occurs primarily because of: 1) an increase in oil prices from approximately $15 per barrel to $22; 2) a deposit from the State Auditor that was recorded as revenue rather than a residual equity transfer; and 3) a decrease of $3.1 million in expected revenue from foreign depository taxes due to later and less frequent deposits.

EXPENDITURE INCREASE

Anticipated general expenditures increase by $59.7 million over the amount anticipated during the May 2000 Special Session. There are two primary reasons for this increase: 1) corrections populations are projected to rise faster than originally projected, increasing anticipated expenditures by a further $7.1 million over the biennium; and 2) increases in mental health costs in the Department of Public Health and Human Services are significantly higher than anticipated for both the Medicaid and non-Medicaid populations, as are non-mental health Medicaid costs (the department has indicated it will seek a supplemental appropriation for these programs in fiscal 2001). In addition, a number of other factors increased the projected cost over the anticipated level, including pay exceptions for correctional officers awarded in fiscal 2001 and 2002, and a smaller than anticipated reduction in the rate at which Montana must match Medicaid costs. A change in the way Montana accounts for drug rebate revenue is also reflected in the higher expenditure totals. However, this increase of almost $10.0 million is offset by a corresponding increase in general fund revenue.

STRUCTURAL BALANCE

Structural balance refers to the matching of ongoing expenditures of government with ongoing revenues. If revenues equal or exceed the expenditures, then structural balance is achieved. If expenditures exceed revenues, then structural imbalance occurs. General fund expenditures chronically exceeded ongoing revenues for several biennia in the 1980s and early 1990s. In order to keep the account solvent during that time, the legislature approved numerous one-time transfers from other accounts into the general fund and enacted several temporary revenue increases.

During the 1993 session, the legislature began to make progress toward addressing the problem of a continuing structural imbalance in the general fund. In setting revenue and expenditure targets, the House adopted language prohibiting use of "one-time revenue...for any purpose other than creating an ending fund balance" and "temporary solutions to the state's chronic fiscal woes." This effort continued into future sessions, and final legislative actions during both 1993 sessions and future sessions have reflected these objectives. However, supplementals, including fire suppression costs (which are unbudgeted) have contributed to a small negative cash flow each biennium.

On the expenditure side, legislators have faced the ever-present difficulty of holding down budget growth when confronted with double-digit percentage growth in corrections costs, increased human services demands, rising enrollments and funding requirements in education, and a larger debt service obligation. In the 1993 and subsequent sessions, the legislature also enacted measures to contain costs in programs that were growing faster than revenues, such as Medicaid and foster care. These measures were designed to slow expenditure growth, thus helping the legislature reach structural balance in the general fund in future biennia.

The effort to minimize use of one-time revenues and to enact measures to permanently control expenditure growth has begun to show success in recent biennia. However, it appears that the state has lost ground as we head toward the 2003 biennium. Table 3 shows anticipated present law revenues will only slightly exceed present law expenditures during the 2003 biennium. As noted earlier, this is attributable largely to an increase in expenditures. Revenues have shown a fairly consistent growth rate of 2 to 3 percent each biennium. However, two issues could result in a significant structural imbalance: 1) passage of any or all of the initiatives before the electorate in November; and 2) the expenditure of the $37.0 million local government reimbursement reserve set aside by the legislature in the May 2000 Special Session.

Although there is a structural imbalance reflected in this projection, it is not as significant as experienced several years ago. It is important to be aware of this issue of structural balance (or “imbalance”) as the legislature considers and debates the 2003 biennium budget.

CONCLUSION

The general fund present law financial position facing the 2001 legislature is far worse than was expected just a few months ago. The current budget outlook projected for the 2003 biennium can be attributed primarily to two factors: 1) an increase in anticipated expenditures in the 2003 biennium, resulting primarily from growth in human services and corrections caseload, and continuation of anticipated human services supplemental appropriations; and 2) sizable supplementals for the 2001 biennium, including significant fire suppression costs. Revenues reflect a moderate growth trend with individual income tax revenue continuing to experience the strongest growth, while other categories reflect decreases or modest increases.

In addition, it is important to recognize that there are three ballot initiatives that may be approved by the voters in November, any one of which would reduce the projected fund balance. Collectively, they have the potential of reducing the fund balance to a negative $25.4 million.

All of this does not bode well for the impacts of the executive’s new proposals or legislative initiatives that would reduce revenue or increase expenditures. Historically, the legislature has approved new proposals at levels averaging $75 million each biennium.

This rather bleak projection of the general fund balance for the upcoming biennium depends upon continued average growth in income and property taxes, and maintenance of current collection levels for all other general fund revenue sources (property and income tax revenues account for almost two-thirds of general fund revenue collections in the 2001 biennium). Any downturn in the economy that slows wages and business incomes quickly translates into revenue collections below expectations. There are a number of troubling signs that appear to indicate economic slowdown in future biennia. As an example, wage growth appears to be slowing when compared to recent years. In addition, there are uncertainties about how long the state can expect to experience continued slow rates of growth in human services expenditures and education enrollment declines. The legislature may want to weigh these factors in establishing state fiscal policy.

I:\Legislative_Fiscal_Division\LFD_Finance_Committee\LFC_Reports\Oct_00\BIGPIC2003.doc